Docket No. 02-0067
ICC STAFF EXHIBIT 2.0R
Public

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Commerce Commission on its own motion	))	Docket No. 01-0705
Northern Illinois Gas Company d/b/a NICOR Gas Company	)))	
Reconciliation of Revenues collected under Gas Adjustment Charges with Actual Costs prudently incurred	))))	
Illinois Commerce Commission on its own motion	)))	Docket No. 02-0067
Northern Illinois Gas Company d/b/a NICOR Gas Company	)))	
Proceeding to review Rider 4, Gas Cost, pursuant to Section 9-244(c) of the Public Utilities Act	))))	
Illinois Commerce Commission on its own motion	)))	Docket No. 02-0725
Northern Illinois Gas Company d/b/a NICOR Gas Company	)))	
Reconciliation of Revenues collected under Gas Adjustment Charges with Actual Costs prudently incurred	))	

REVISED
DIRECT TESTIMONY ON REOPENING

OF

MARK MAPLE

Senior Gas Engineer

Energy Division—Engineering Department

March 9, 2011

****PUBLIC VERSION** (Marked by XXXXX)**

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Q. Please state your name and business address.

A. My name is Mark Maple and my business address is: Illinois Commerce Commission, 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. By whom are you employed and in what capacity?

A. I am employed by the Illinois Commerce Commission (“Commission”) as a Senior Gas Engineer in the Engineering Department of the Energy Division.

Q. Please state your educational background.

A. I hold a Bachelor of Science degree in Mechanical Engineering and a minor in Mathematics from Southern Illinois University - Carbondale. I also received a Master’s degree in Business Administration from the University of Illinois at Springfield. Finally, I am a registered Professional Engineer Intern in the State of Illinois.

Q. What are your duties and responsibilities as a Gas Engineer in the Engineering Department?

A. My primary responsibilities and duties are in the performance of studies and analyses dealing with the day-to-day and long-term operations and planning of the gas utilities serving Illinois. For example, I review purchased gas adjustment clause reconciliations, rate base additions, levels of natural gas used for working capital, and review utilities' applications for Certificates of Public Convenience and Necessity. I also perform utility gas meter test shop audits. Finally, I provide expert testimony in cases before the Commission, including Docket 99-0127, in which Nicor Gas Company sought permission to institute the performance-based program currently under review.

Q. What do you rely upon to conduct your analyses of the operations of gas utilities serving Illinois?

A. Staff relies upon information provided by the gas utilities in order to review their plans and operations. I send out data requests for technical data and the bases for their activities and rely upon them being forthright and accurate in their responses. Typically, there is no independent third party source. The information I need is about the public utility and is only available from the public utility. Therefore, I rely upon the data and the responses provided by gas utility personnel.

Q. What is the subject matter of your testimony?

A. This testimony presents the findings of my investigation, since July 2002, of Nicor Gas Company ("Nicor" or "Company"), involving the costs included in the

Company's purchased gas adjustment clause ("PGA") in 1999 through 2002, and the Company's Gas Cost Performance Program ("GCPP" or "PBR"), which was in effect in 2000 through 2002. This investigation began when the Citizens Utility Board ("CUB") received a fourteen-page fax from a whistle-blower, alleging certain improprieties on the part of Nicor Gas surrounding the GCPP.

Q. What recommendations are you making in your direct testimony?

A. I make three recommendations as well as discuss some of Nicor's practices leading up to and during the PBR. First, I recommend that the Commission lower the benchmark by $983,511 for each of the three years the PBR was in place, to reflect the actual costs of contracts signed by Nicor before the final order was issued in Docket No. 99-0127.

Second, I recommend that the Commission lower the benchmark by $3,928,981 for each of the three years the PBR was in place, to reflect the correct amount of capacity management credits that should have been included in the original benchmark.

Third, I recommend that the Commission order Nicor to refund $3,216,169 to customers, due to capacity management credits that the Company should have obtained for customers in 1999.

The combined impact of these three recommendations is a refund to customers of $10,584,908, as shown in Table 1 below.

Table 1 Recommendation	Decrease in Benchmark or Costs	No. of Years Decrease is Applicable	Applicable Ratepayer Share	Refund
#1 (contracts)	$983,511	3	50%	$1,475,267
#2 (cap mgmt credits 2000-02)	$3,928,981	3	50%	$5,893,472
#3 (cap mgmt credits 1999)	$3,216,169	1	100%	$3,216,169
Total				**$10,584,908**

Finally, my testimony addresses several of Nicor's acts and omissions related to the PGAs and the PBR from 1999 through 2002. This factual background supports in a general sense some of Staff witness Zuraski's adjustments, as well as my own.

Q. What did you rely upon when you conducted your analysis in this docket?

A. After the July 16, 2002 Interim Order was entered, Staff and the parties proceeded to conduct discovery. I relied upon the responses to discovery, including the discovery depositions which were conducted in June through July of 2003 in conducting my analysis and formulating my opinions.

Q. What discovery depositions are you referencing?

A. During the discovery phase of this case, pursuant to motions filed by Staff on May 30 and July 22, 2003, discovery depositions were taken of thirteen Nicor employees and officers in order to help determine what had taken place at Nicor in regards to the PGAs and PBR. In my testimony below, I cite the transcripts of those depositions, as well as the testimony put forth by Nicor during the original PBR case in Docket No. 99-0127. The reader may be unfamiliar with the various Company deponents and their positions and duties within the Company. Therefore, I provide in this section a basic description of the various deponents that I quote in my testimony. It is important to note that the majority of these Nicor employees were either X X X X X X X X X X X XX X X X X X X X X X X X X X X X X X X X X X X (Nicor response to data request ICC 42.01).

<u>Short Biographies on Company Employees Cited</u>

<u>George Behrens</u>

Mr. Behrens became the Treasurer and Vice President of Administration of Nicor in early 2002. From 1996 to 2002, Mr. Behrens was Vice President of Accounting for Nicor. Mr. Behrens was responsible for overseeing the financial aspects of the company. This included monitoring the PBR and evaluating the resulting profits or losses. Mr. Behrens was also a witness in this proceeding and filed testimony in support of the PBR. X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X (Id.).

Leonard Gilmore

Mr. Gilmore has been employed by Nicor for 30 years and currently serves as the General Manager of Gas Supply. During the PBR, he was the Manager of Pipeline Regulation and Supply Planning. Among other duties, Mr. Gilmore was responsible for negotiating pipeline transportation and storage contracts. Mr. Gilmore was a witness in the 99-0127 PBR case, where he testified in support of the PBR. Specifically, Mr. Gilmore was involved in the conception of the various components of the benchmark, including the Firm Deliverability Adjustment and the Storage Credit Adjustment.

Albert Harms

Mr. Harms was employed by Nicor from 1972 - 2003. During the PBR, he was the Manager of Rate Research, a position he held for approximately 17 years. Among other duties, Mr. Harms was in charge of overseeing the majority of filings made with the Commission. He also acted as a liaison to ICC Staff and assisted Staff with its discovery process. Mr. Harms was a witness in the 99-0127 PBR case and testified in support of the PBR.

<u>Beth Hohisel</u>

Ms. Hohisel started her employment at Nicor in 1985. During the PBR, she was the Manager of Supply Services, which she held since 1998. Among other duties, Ms. Hohisel was responsible for managing the Company's supply of natural gas, including buying and selling supplies. X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X (Id.).

<u>Theodore Lenart</u>

Mr. Lenart started his employment at Nicor in 1997. He was the Assistant Vice President of Supply Operations at Nicor from 1999 to his departure from Nicor. Mr. Lenart was responsible for overseeing storage operations, gas control, and gas purchasing. X X X X X X X X X X X X X X X X X X X X X X X X X X X X (Id.).

<u>Jeffrey Metz</u>

Mr. Metz was employed by Nicor from 1981 - 2005. In mid-1999, Mr. Metz was promoted from the position of Director of Management Accounting to the position of General Manager of Accounting. In 2000, he was promoted to the position of Assistant Vice President and Controller. In January of 2003, Mr. Metz was promoted to the position of Vice President and Controller at Nicor. During the years 1999 - 2002, Mr. Metz was responsible for a number of departments, including Gas Supply Accounting. Among other duties, Mr. Metz was responsible for overseeing the accounting of the PBR program and reporting those results to Nicor officers. X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X (Id.).

Richard Rayappan

Mr. Rayappan was employed by Nicor from 1999 - 2004. His final position was Manager of Treasury and Investments at Nicor. From October 2000 to July 2003, Mr. Rayappan was the Director of Supply Accounting at Nicor. Among other duties, Mr. Rayappan was responsible for reviewing the accounting of the various components of the PBR, and for calculating Nicor's financial restatements due to the findings of the Lassar Report. X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X (Id.).

Lonnie Upshaw

Mr. Upshaw worked for Nicor from 1977 to 2002. During that time he held various positions related to gas transmission and storage operations, with his last position being Vice President of Supply and Technical Services. Mr. Upshaw was one of the employees responsible for the conception and implementation of the PBR. Among other duties, Mr. Upshaw was in charge of overseeing the implementation of the PBR, especially from a transactional and supply viewpoint. X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X

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Low Cost LIFO Layers in Storage

Q. Explain your understanding of Nicor's physical storage options.

A. Nicor uses a combination of Company owned storage and leased storage services. Nicor owns a number of underground storage fields in Illinois, which make up the majority of the Company's storage capacity. Nicor also leases storage from interstate pipeline companies to provide a seasonal price hedge, extra peak day deliverability and balancing services.

Q. What accounting method does Nicor use for its storage inventory?

A. Nicor uses the LIFO ("Last In, First Out") inventory costing method. Thus, when Nicor withdraws gas from storage, it is assumed that the most recently created layers are removed first for accounting purposes.

Q. How does LIFO accounting affect the price of gas in storage?

A. At the end of each calendar year, Nicor totals the injections and withdrawals to determine if there was a net injection or withdrawal for the year. If there was a net injection, there would be a "layer" of gas created in inventory that is priced at the average cost of gas for the entire year. If there was a net withdrawal, the Company first reduces the top layer of storage gas. If the net withdrawal was large enough, the Company could eliminate one or more layers of inventory.

Q. How has LIFO accounting affected Nicor's storage inventory over the years?

A. Decades ago, Nicor experienced significant net injections, which created layers of storage gas. This gas was acquired at a price far below what the market charges today. As the storage fields were developed and end-of-year storage balances grew, these low-cost LIFO layers became increasingly "trapped," albeit strictly in an accounting sense. That is, due to the LIFO accounting method, it became increasingly unlikely that these lower priced layers would be accessed, unless Nicor withdrew more gas than it injected over a number of consecutive calendar years.

Q. Has Nicor always recognized the embedded value of these low-cost LIFO layers?

A. Nicor may have been conscious that some of those layers were priced well below current market prices. However, it did not recognize the potential for shareholders to tap into this value until late in the 1990's. X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X

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Q. Did the Company take steps to further develop X X X X X X idea for shareholders to profit from the low-cost LIFO layers?

A. Yes. In 1998, a group of Nicor employees were assembled into what became known as the “Inventory Value Team.” The mission of the team was to quantify the value of the low-cost LIFO layers and develop strategies to extract that value for shareholders. X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X

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Q. Was the Inventory Value Team able to quantify the value of the low-cost LIFO layers?

A. Yes. The Team wrote a report, the Inventory Value Team Report ("Report"), in October 1998 in which they quantified the value of LIFO layers. On page three of the Report, the Team valued the layers at a book value of $128 million. Additionally, the layers had a market value of between $93 - $203 million in excess of the book value. (Stipulated Exhibit 1, p. 3, NIC 049927).

Q. What did the Inventory Value Team conclude, and what happened following the issuance of the Inventory Value Team Report?

A. On page 2, Roman II of the team's Report, it states, "We recommend that the company 'capture' the LIFO inventory value by filing and implementing a Gas Rate Performance Plan (GRPP) related to gas costs." (Stipulated Exhibit 1, p. 2, NIC 049926).

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Q. Do you believe that the Company would have pursued a PBR if there were no low-cost LIFO gas?

A. I believe that Nicor would not have pursued the PBR in 1999, absent the ability to generate savings by tapping into the low-cost LIFO gas. X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X

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Additionally, consider the text from a presentation given by Nicor management:

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Q. Why was the existence of the low-cost LIFO layers so critical to the Company's acceptance of a PBR program?

A. The LIFO layers were basically a guaranteed moneymaker in an otherwise risky and uncertain PBR program. XXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

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Q. Given that the low-cost LIFO layers were so valuable and seemed to play such an important role in the decision to implement the PBR, did Nicor tell Staff and the other interveners about the significance of these layers during the 1999 case?

A. No, it did not. The Company did not provide any information regarding the Company's plans to monetize the low-cost LIFO layers during the 1999 case.

As I will discuss later, Nicor withheld relevant documents from Staff in response to data requests, and changed the format of reports to hide the LIFO benefit. Furthermore, according to four key Nicor employees, there was a shared sense among Company employees that the LIFO benefit was not to be "highlighted."

Q. Do you think during the 1999 PBR case, in the absence of any notice from the Company of its plans, Staff should have been aware of the potential for Nicor to monetize the layers and profit from them?

A. No. First, one must understand that Staff is highly dependent on the Company to provide accurate and reliable information during cases. For much of the information concerning the Company's physical and financial transactions, Staff cannot go to a trade publication or to some third party for investigation. That information must come from Nicor itself. As I will discuss later in testimony, Nicor withheld this information and misled Staff on its intentions concerning storage gas. It doesn't matter what had been provided in cases from previous years – all information relevant to the 1999 case should have been disclosed during that case. The fact of the matter is that Nicor did not disclose anything about either the status of its LIFO inventory or its intent to tap into that value.

Second, even if Staff members knew or should have known about the existence of the LIFO layers that is still a far cry from Staff knowing that Nicor had discovered a viable scheme to monetize these low-cost layers by manipulating net withdrawals. In fact, Staff was repeatedly told in Nicor's testimony and data request responses during the 1999 PBR case that Nicor had no ability to change its storage withdrawal patterns. This is important because the LIFO layers could only be accessed if Nicor changed its withdrawal patterns, since on average Nicor had been injecting more gas than it had been withdrawing. Consider the testimony of Mr. Gilmore in 99-0127:

> *…The Company's ability to control the timing and quantity of withdrawals is therefore very limited. (Stipulated Exhibit 4, Company's Response to Staff Data Request ENG 1.1, 99-0127).*

> *…Accordingly, the Company has no incentive under the GCPP to inappropriately shift storage. (Gilmore Rebuttal, p. 6, 99-0127).*

> *…Mr. Iannello's reason for proposing alternatives to the Company's*

> *computation is his claim that the Company has an incentive to manipulate storage withdrawals. As I have shown, this claim is incorrect. (Gilmore Rebuttal, pp. 6-7, 99-0127).*

During oral arguments before the Commissioners, Company attorney Mr. Mattson even scoffed at Staff's allegations that Nicor could manipulate storage withdrawals, saying:

> *And they [Staff] said, ah-huh, we found a way you can manipulate the system.* ***In the real world that couldn't happen****. (emphasis added) (Transcript of November 2, 1999 Oral Arguments, p. 55).*

The Company and its witnesses continued to give misleading information to Staff, X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X

> *X (Stipulated Exhibit 16, NIC 003213).*

Third, as explained later in my testimony, Nicor made it a point to "not highlight" its intentions of monetizing the LIFO layers. Thus, as X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X

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Finally, Nicor was using practices that were new to Staff. Knowing that the Company had value stored in low-cost LIFO layers did not endow Staff with the knowledge of how or if Nicor would extract that value. Staff attempted to investigate Nicor's potential to manipulate storage withdrawals. But because Nicor provided Staff with incomplete answers and misleading testimony, Staff was unable to detect Nicor's intentions to monetize the LIFO layers.

Inflation of the Firm Deliverability Adjustment Component

Q. What is the Firm Deliverability Adjustment?

A. The Firm Deliverability Adjustment (FDA) is one of the components of the PBR benchmark. It was conceived by the Company and accepted by the Commission in the 1999 PBR case (Docket 99-0127). The FDA was set at $116,582,612 for the duration of the PBR and did not fluctuate with the market. The FDA was an attempt to represent Nicor's annual fixed costs for reserving firm transportation and purchased storage capacity, less credits received by the Company when it releases excess capacity, sells excess gas, or conducts certain other transactions.

Q. How did the Commission establish the $116,582,612 FDA value in Docket 99-0127?

A. The Commission agreed to use Staff's methodology of averaging the projected costs and credits over the first two years of the PBR program, 2000 and 2001, since the benchmark would only be in place for two years before a review was initiated. (Section 9-244(c) of the Illinois Public Utilities Act mandated that the Commission review the program after two years to ensure that it was meeting its objectives.)

Q. How did Staff project the costs and credits that Nicor was likely to incur and receive during 2000 and 2001?

A. Many of the pipeline and storage costs were known because the Company had already signed multi-year contracts. However, there were two uncertain issues: 1) Nicor's estimates of capacity management credits to be earned during the PBR; and 2) the costs to reserve capacity on the Midwestern and Tennessee

Pipelines. Staff contested the Company's original positions with respect to these two issues.

Q. Did the Commission side with Nicor or Staff on these two issues?

A. Actually, the Commission reached a compromise on both issues.

Q. Was the Commission provided with all the relevant information necessary to make a sound determination on those issues?

A. No. Nicor withheld and/or manipulated crucial information throughout the 1999 docket. This deprived the Commission of a full and complete record upon which to base its decision. I recommend that the FDA should be reconsidered now that that crucial information is available. To the extent the FDA component was arrived at based upon the Company's manipulation of both the revenues and the negotiation processes, the use of it does not result in an equitable sharing of the net economic benefits of the PBR between the utility and its customers. I recommend that the benchmark be modified to accurately reflect the FDA

Q. To what crucial information are you referring?

A. Through my investigation since July 2002, I have determined that Nicor withheld information from Staff and manipulated both its revenues and its negotiation processes in order to establish a higher FDA. This higher FDA, in turn, resulted in a PBR benchmark that was more favorable to the Company. I note further that Nicor's manipulation not only affected the benchmark and the computation of savings under the PBR program, but also served to directly increase costs to ratepayers in 1999. Below, I provide an explanation of the two issues.

<u>Negotiations with Midwestern & Tennessee Pipelines</u>

Q. Why was Nicor negotiating with Midwestern and Tennessee Pipelines?

A. Midwestern Gas Transmission Company ("Midwestern") and Tennessee Gas Pipeline Co. ("Tennessee") are two interstate pipelines that Nicor uses to transport gas to its system. In 1999, Nicor had contracts in place with both pipelines. These contracts were set to expire in October 2000. It was typical practice for Nicor to start negotiating new contracts with the pipelines well in advance of the contract expiration date to ensure that service was not interrupted. Nicor does not typically purchase capacity from the pipelines at maximum rates, but rather it uses its size and market position to negotiate discounts.

Q. What was Staff's issue during the 1999 PBR case?

A. On March 22, 1999, Nicor received an initial offer from the pipelines for the new contracts that would go into effect in October 2000. As with most negotiation processes, the first offer is often the highest offer and is unlikely to represent the final accepted terms. Nicor attempted to use the initial offer as the basis for setting the FDA. Staff argued that it was extremely likely that Nicor would negotiate rates lower than the initial offer, which would then leave the benchmark artificially high and detrimental to ratepayers. Thus, Staff recommended that the Commission assume a certain percentage discount would be achieved with Midwestern and Tennessee.

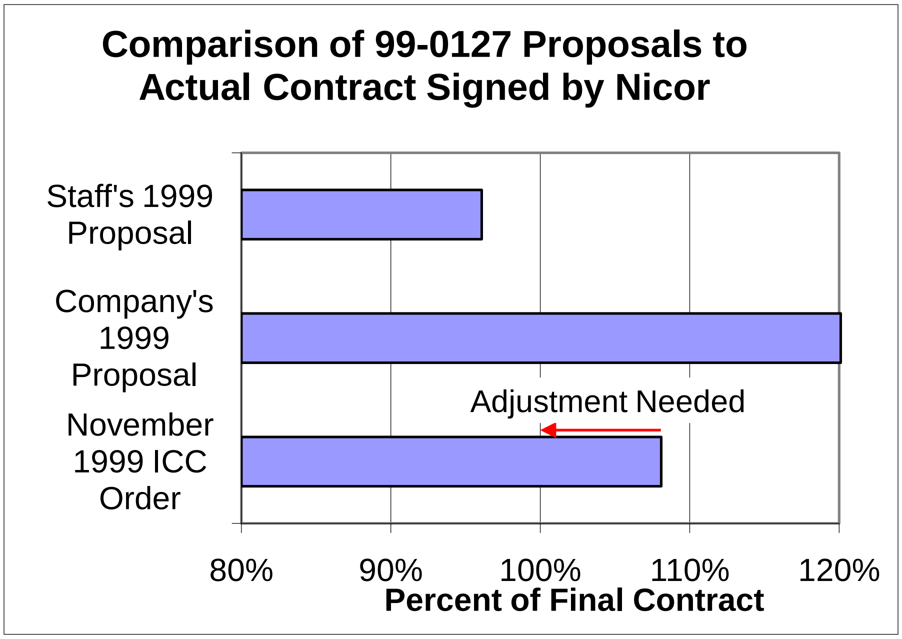
Q. What did the Commission decide on this issue?

A. The Commission agreed that a discount was likely, although it disagreed with Staff on the magnitude of this discount. Ultimately, the Commission decided that a discount half the size of Staff's proposal was likely.

Q. Did the Company actually realize a discount from the Midwestern/Tennessee negotiations?

A. Yes. The actual discount received was greater than the value accepted by the Commission, but slightly lower than Staff's prediction. However, the results validated Staff's argument that Nicor could realize significant discounts during the negotiation process.

Table 2 **Annual Cost for New Midwestern / Tennessee Contracts**			
October 1999 Final Contract	*November 1999 ICC Order*	*Company's 1999 Proposal*	*Staff's 1999 Proposal*
XXXXXX	XXXXXXX	XXXXXXX	XXXXXXX



Q. Did Nicor do anything during the 99-0127 proceeding to overstate the likely Midwestern and Tennessee contract costs and inflate the benchmark?

A. Yes, it now appears that Nicor deliberately halted negotiations with Midwestern and Tennessee until the case was nearly over. Nicor had traditionally been successful in achieving discounts through negotiations. If Nicor had negotiated its discount before the proposed order was issued, the benchmark would have likely reflected the entire amount of the discount. This would have correctly lowered the benchmark and made it harder for Nicor to profit from the PBR.

Faced with this prospect, it appears that Nicor deliberately put a halt to negotiations with Midwestern and Tennessee during the case. Nicor resumed negotiations sometime after the HEPO was issued when no more evidence would be entered into the record. Nicor finalized its contracts in October of 1999, which was one month before the Commission issued its final order.

Q. What evidence do you have to substantiate your claims that Nicor deliberately halted negotiations with Midwestern and Tennessee until Docket 99-0127 was nearly over?

A. In X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X, there was the following exchange:

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Notably, Mr. Gilmore was the Company's witness on this issue in Docket 99-0127 and was responsible for negotiating contracts with pipeline companies. I have since confirmed that Nicor had agreed to terms with Midwestern and

Tennessee on or about October 18, 1999. (Stipulated Exhibit 5, Nicor Response to data request ICC 27.01).

Nicor received notice from Tennessee Pipeline as far back as December 18, 1998 stating that the current contract would expire November 1, 2000 (Stipulated Exhibit 15, NIC 114589-92). Furthermore, Nicor was notified that it must notify the pipeline by October 31, 1999 on its intentions to negotiate a new contract, otherwise the contract would automatically renew at maximum rates. I am aware of many of Nicor's contracts with pipelines. X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X Nicor had almost a full year from its first notice in which it could negotiate a new contract. However, Nicor waited until the eleventh hour to come to an agreement – right after the initial briefing phase had been completed. By doing this, Nicor avoided the inclusion of the new, lower rates in the FDA. Including the higher rates raised the FDA, making it easier for Nicor to meet the benchmark and thus create "savings." This benefited Nicor while it harmed ratepayers.

Q. What is your proposal in light of this new information?

A. In light of Nicor's deliberate delay in concluding negotiations, I recommend that the Commission apply the entire amount of the actual discount to the FDA. This would effectively lower the benchmark for 2000, 2001, and 2002. Table 3 below shows this adjustment, which amounts to a reduction in the benchmark of $983,511 for each of the three years that the PBR was in effect.

Table 3

Midwestern & Tennessee Costs in Benchmark

2 Year Average Based on 1999 Order (Nov 99)	X X X X X X X X
2 Year Average Based on Actual Contract (Oct 99)	X X X X X X X X
Value of Proposed Adjustment to Benchmark	**$ 983,511**

Capacity Management Credits

Q. What are capacity management credits?

A. The Company reserves a large amount of interstate pipeline capacity to meet system demand during the coldest peak days. During warmer, non-peak days, there is an excess of capacity that goes unused by the Company. Nicor can use this excess capacity to meet the needs of marketers and other utilities by conducting capacity releases, buy/sells, supply sales, and storage credits. Under traditional PGA regulation, the Company flows these revenues, which are classified generally as capacity management credits, back to ratepayers. Under the PBR, these capacity management credits continued to lower costs for ratepayers, but were shared 50/50 with the Company. Thus, in Docket 99-0127, a projected amount of such capacity management credits was included in the

PBR benchmark—specifically as a reduction in the Firm Deliverability Adjustment.

Q. What amount of capacity management credits was built into the FDA in Docket 99-0127?

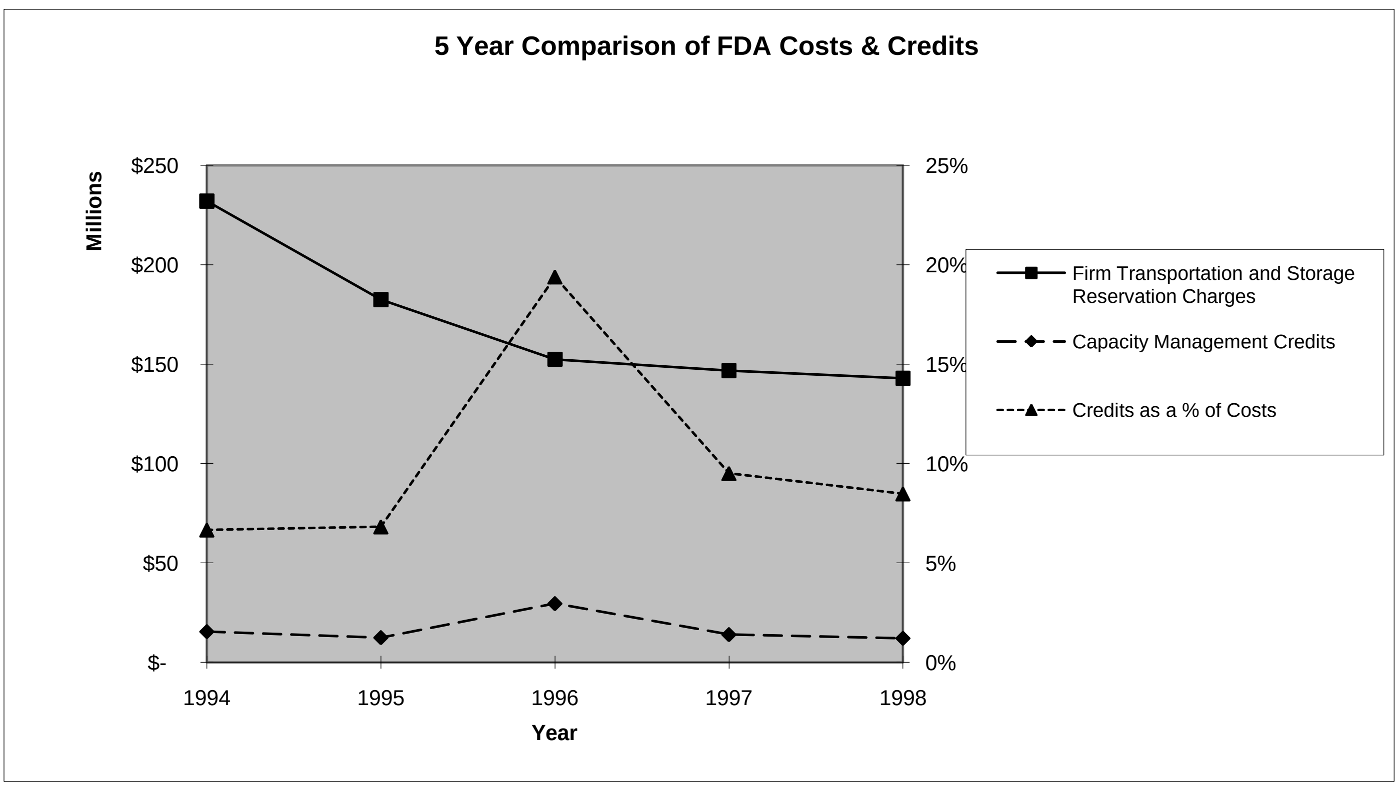
A. In Docket 99-0127, the Commission used a modified version of the most recent twelve months of capacity management credits (as of October 1999) as the basis for setting the FDA. The modification, which Staff argued against, took a ratio of the last twelve months of FDA costs vs. the FDA costs established in the benchmark. This ratio adjustment, which was opposed by Staff, lowered the capacity management credits by approximately $800,000, and resulted in an established benchmark credit of $8,185,672.

Q. What was the rationale for multiplying the last twelve months of capacity management credits by the ratio of the last twelve months of FDA costs vs. the FDA costs established in the benchmark?

A. Nicor argued that its costs to reserve transportation had been declining, and thus the market value for that capacity was also declining. (Gilmore Surrebuttal, p. 10, Docket No. 99-0127) The Commission agreed with the Company and ordered it to determine the ratio of decline for the FDA costs, and apply that ratio to the credits.

Q. Did Staff agree with Nicor's argument that capacity management credits were declining and would decline in the future?

A. No. Staff demonstrated that even though the Company had cut its FDA costs by over $89 million over a five-year period, the capacity management credits decreased by only $3.3 million (Staff's Brief on Exceptions, 99-0127, pp. 3-4). The credits in 1998 were actually higher as a percentage of FDA costs than they were in 1994. So Staff argued there was no evidence that capacity management credits would decrease much, if at all, during the PBR program.



Q. The Commission ruled in favor of Nicor on this issue in 1999. Why are you recommending the Commission revisit this issue?

A. The Commission has reopened the biennial review of the results of that case (Docket No. 02-0067), and has consolidated it with several PGA reconciliations (Docket Nos. 01-0705 and 02-0725), in order to consider new evidence in light of the revelations that came to light in the summer of 2002. These revelations are outlined in the Lassar Report (Stipulated Exhibit 6) and addressed throughout Staff’s testimony in these consolidated proceedings.

I believe, for example, that Nicor’s failure to divulge its intent to use the PBR to monetize the LIFO layers (see supra, pp. 12-18 and Stipulated Exhibit 1) provides additional context which should be considered by the Commission when considering the capacity management credits. The Commission should reconsider its calculation of the FDA costs and capacity management credits in light of the other problems in Nicor’s presentation to the Commission and responses to discovery in matters related to the PBR, documented elsewhere in Staff’s evidence. This reevaluation is necessary in order for the Commission to determine how to make Nicor’s customers whole for any amounts the Commission determines Nicor to have unjustly charged.

Q. Is there anything in particular that caused you to reconsider the capacity management credits issue now?

A. Yes. When I reviewed the additional information provided by Nicor as data request responses, I saw a document that raised my suspicions about the information Nicor previously provided about the capacity management credits.

Q. Please describe that document.

A. The document X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X (Stipulated Exhibit 16).[1] X

Q. Why did this document cause you to reconsider the capacity management credits issue?

A. X

Q. Did the Company have any incentive to inflate the benchmark by understating capacity management credits?

[1] X

A. Yes. Because the credits effectively reduce the benchmark and make it harder for the Company to achieve “savings” relative to the benchmark, Nicor stood to gain by somehow lowering the 1999 credits. Any reduction in such credits prior to the start of the PBR would not hurt the Company because 100% of the credits would have been passed back to ratepayers anyway, under the formula in the Commission’s PGA rules and the Company’s PGA tariffs.

Q. Did Nicor have the opportunity to lower the 1999 capacity management credits?

A. Yes. The Inventory Value Team Report (Stipulated Exhibit 1), which recommended that Nicor implement a GCPP in order to monetize the LIFO layers, was issued in October 1998. (Co. Response to Staff DR ICC 2.14) The Inventory Value Team Report expressly recognizes the effect of capacity management credits on the benchmark:

> Revenues that lower the benchmark are capacity release revenues (includes buy-sells, linked purchases and sales) and storage management credits. Capacity release credits for 1998 are forecasted to be $9.5 million and 1998 credit from storage management will be about $5.2 million. Subsequent years should generate similar credits. [Stipulated Exhibit 1, p. 12, NIC 049936]

This shows that Nicor recognized the adverse affect that these credits would have on the benchmark, and thus Nicor’s profit under the PBR. In order to lessen this adverse affect, Nicor would need to change its capacity management strategy for 1999 to lower the credits it obtained for customers.

Q. Could Nicor have changed its capacity management strategy for 1999 within that time period?

A. Yes. Utilities structure most of these capacity management transactions for periods of less than one year. In fact, many of them are transacted on a monthly or even daily basis. When the Inventory Value Team Report was written, it is unlikely that very much, if any of the 1999 capacity management transactions were already locked in place. Therefore, there was plenty of time to change its capacity management strategy in 1999.

Q. Is there any evidence that Nicor generated lower capacity management credits in 1999 than in the years immediately before and after 1999?

A. Yes. The actual numbers for capacity releases in 1998, 1999, and 2000 show that the capacity management credits Nicor generated in 1999 were significantly lower than the capacity management credits generated in the other years. This decrease occurred despite the 1998 forecast that projected credits for 1999 that were in line with the other years (Id).

Q. Please elaborate on the numbers demonstrating Nicor's capacity release performance during those three years.

A. Refer to Table 4 below. In 1999, the credits dropped to the lowest level in recent history, down more than $3.2 million from the previous year. But as soon as the PBR went into effect, the credits increased substantially by more than $8 million. Not only did the Company generate extraordinarily low capacity management credits during 1999, but also it outperformed historical levels during 2000. This is contrary to the position that the Company so vigorously argued in 99-0127, that credits would continue to decline into the future due to lower prices and lower market demand.

Table 4
Capacity Management Credits

1998	*1999*	*2000*
$ 12,114,653	$ 8,898,484	$ 17,588,882

Q. Did lowered revenues from capacity releases during 1999 only hurt customers during the PBR, through its effect on the benchmark?

A. No. It is true that customers were hurt during the PBR by having an inflated benchmark. However, customers were also hurt in 1999 by Nicor's lax attempts to earn credits for the ratepayers, of which customers would have received 100% of the benefits.

Q. What adjustments do you propose as a result of the Company's manipulation of the 1999 capacity management credits?

A. My adjustment is twofold. First, the Company should have worked harder in 1999 to earn credits for customers. By looking at the credits from 2000, one could easily argue that Nicor should have received over $8 million more in 1999. However, I recognize that the PBR gave the Company incentive to “turn over new stones” to realize more credits. But it is totally conceivable that in 1999, the Company could have replicated its performance in 1998, where it earned $12.1 million in credits. I believe that had Nicor not reined in its efforts to generate capacity management credits in the months prior to the order in the 99-0127 proceeding, it would, at a minimum, have replicated its 1998 performance. Therefore, my first adjustment is to increase the amount of credits received in 1999 by $3,216,169. These credits should be refunded to customers as part of the PGA reconciliation for 1999.

My second adjustment is to lower the FDA portion of the benchmark for years 2000-2002. I am making this adjustment to reflect the higher level of capacity management credits that should have been “built into” the FDA. The $8,185,672 level of credits was inaccurate for two reasons: 1) the use of the most recent year’s worth of credits through October 1999, which were artificially low due to Nicor’s apparent strategy of reducing capacity release credits in 1999; and 2) Nicor’s self-serving and faulty argument that the credits should be further lowered to reflect a weaker outlook on future credit opportunities. Thus my adjustment would establish the benchmark value of capacity management credits to be

$12,114,653. This in turn would lower the FDA by $3,928,981 for each of the three years it was in effect.

<u>Savings Under the Benchmark</u>

Q. Please explain the relationship between the benchmark and savings.

A. The benchmark was created to set a standard against which Nicor's performance under the PBR could be measured. The benchmark was to reflect what actual gas costs would have been under the traditional purchased gas adjustment clause. To the extent that the benchmark was manipulated to be higher than gas costs would have been in the absence of the PBR, it does not serve as an accurate standard. The benchmark will only accurately determine whether savings have been realized to the extent the benchmark is an accurate indicator of what gas costs would have been under traditional regulation. If the benchmark was not an accurate reflection of what gas costs would have been under traditional regulation, then differences between the benchmark and actual gas costs do not reflect savings to customers. In other words, the benchmark is an artificial standard; the customers NEVER realized savings due simply to the difference between the benchmark and actual gas costs. In fact, the customers paid Nicor 50% of the difference between the benchmark and actual gas costs. To the extent the benchmark was inflated, the customers paid Nicor 50% of costs that did not reflect real savings. Any savings the customers realized are due strictly to the lowering of actual gas costs, irrespective of the benchmark, and even then customers realized only 50% of such savings. Conversely, Nicor realized savings ONLY from the difference between the benchmark and actual gas costs. By inflating the benchmark, it was easier to beat; there was a broader range in which customers would be paying 50% of the so-called savings. Lowering actual gas costs was only profitable to Nicor if it increased the spread between gas costs and the benchmark.

Therein lies the problem, which is that Nicor had an incentive to inflate the benchmark both during its creation and during the operation of the PBR program. If Nicor could establish a benchmark that was greater than normal gas costs, Nicor would be able to profit from “savings” without truly lowering gas costs and showing real savings for customers. Nicor did indeed inflate the benchmark in 1999, as I illustrated in my arguments regarding the Midwest/Tennessee contracts and the capacity management credits. As Staff Witness Richard Zuraski will testify, Nicor was also able to manipulate and inflate the benchmark during the PBR program by selectively using schemes such as virtual storage and infield transfers. Therefore, Nicor was able to show “savings” that allowed them to profit while actually increasing gas costs for ratepayers.

Q. Were the “savings” realized during the life of the PBR due to better planning, improved purchasing strategies, or other efficiencies on Nicor's part?

A. No. While I do not suggest that every strategy Nicor used ended in failure and losses, apparently most of the Company's strategies to generate "savings" were unsuccessful, even by Nicor's own calculations. By looking at Nicor's year-end, pre-restatement "PBR Buckets" reports, we can see where Nicor estimated that it "saved" money and "lost" money for 2000-2002 (Stipulated Exhibit 17, NIC 002777 & Stipulated Exhibit 18, NIC 110776).

Q. What are the PBR Buckets reports?

A. This portion of my testimony addresses the Company's own calculations of the sources of its savings under the PBR in order to show that the so-called LIFO decrement accounts for the bulk of the savings over the life of the program. At a later point in my testimony, I will demonstrate that these reports should have been disclosed to Staff and CUB in response to data requests before the existence of the whistleblower fax came to light in July 2002.

The buckets reports are spreadsheets created by the Company to quantify and categorize the savings and losses under the PBR. They were distributed throughout the Company on a monthly basis, updating management on the status of the program. At the end of each year, a final buckets analysis was performed which would show the same amount of savings that was reported to Staff. On each report, the total savings under the PBR was calculated up to that point in the year. Then that total was categorized under headings such as “Decrement Value” and “Storage Credits” among others (Stipulated Exhibits 17 and 18, as well as NIC 110775 and NIC 110777).

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Q. Who prepared the PBR Buckets reports?

A. These documents were recognized XX X X X X X X X The similarities between Stipulated Exhibits 17 and 18 support the conclusion that X X X X X X X was also the author of Stipulated Exhibit 18.[2]

[2] Nicor has stipulated that NIC 002777 and 110776, Stipulated Exhibits 17 and 18, respectively, were produced by Nicor in discovery in this matter.
The formats of the two Exhibits are not identical, but bear a striking similarity, including the rectangle at the top of each. The rectangle in SE 17 includes the notation:

PBR Buckets
December, 2001

while the rectangles in SE 18 (NIC 110776), as well as in NIC 110775 and 110777, include the following notation:

PBR Buckets
December, 2002[.]

Also in terms of formatting, the bottom lines of the latter three documents (NIC 110775, 110776, and 110777) show the same author but different times and dates of creation, as well as different filenames, as follows: Stipulated Exhibit 18 (NIC 110776) bears the notations, reading from left to right, “12/27/2002 11:44

Q. What was the basis for the PBR Buckets Reports?

A. X

Q. What was the purpose of the PBR Buckets Reports?

AM," "2002 Buckets 12-7net..xls," and "X X X X X X X X." NIC 110775 bears the notations "12/26/2002 3:25 PM," "2002 Buckets 12-27net..xls," and "X X X X X X X X X." NIC 110777 bears the notations "05/21/2003 1:10 PM," "2002 Buckets2-21net.xls," and "X X X X X X X."

X X X X X X was employed by Nicor Gas from May 15, 2000, until February 26, 2005, holding titles including the word "Accountant" from May 15, 2000, until July 17, 2004 (Nicor Gas response to Staff data Request 43.01).

A. X

The cover memorandum (NIC 002776) for Stipulated Exhibit 17 (NIC 002777) indicates that it was addressed to X

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Q. Looking at the PBR Buckets Report (Stipulated Exhibit 17), what does ‘PBR performance without Decrement’ reference?

A. According to X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X

Q. What does ‘Inventory Decrement and Inventory Balance at year-end’, at the bottom of the PBR Buckets (Stipulated Exhibit 17) reference?

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Q. According to the PBR Buckets Reports, where did Nicor estimate it saved or lost money during 2000-2002?

A. Nicor calculated that it in 2000, it lost $4.4 million on the totality of its PBR performance without the decrement; the decrement value was $28.8 million resulting in total PBR savings of $24.4 million. (See Stipulated Exhibit 17) In 2001, Nicor saved $10 million through its PBR program without the decrement; the decrement value added and additional $19.7 to the PBR savings for a total of

$29.7 million. (Id.) In 2002, Nicor calculated that it saved $9.8 million through the PBR program; the decrement value added $19.5 million, for a total savings of $29.3 million. (Stipulated Exhibit 18)

Q. Overall, what was the effect of the LIFO decrement on Nicor's PBR performance?

A. Based upon the calculations I discussed in my previous answer, during the PBR program, Nicor attributed $68 million to the LIFO decrement. This is over 81% of the total $83.4 million in savings for the entire PBR program. Nicor employee, X X X X X X X X X X, has a similar viewpoint:

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When you consider that the benchmark was inflated, as I have previously discussed and Mr. Zuraski will explain further, that leaves very little "savings", if any, which can be attributed to actual improved performance by Nicor. In fact, according to the Buckets reports referenced above, the Company estimated that it lost $37.7 million during the PBR from the Commodity component alone. This

Commodity component measures, among other things, the prices at which Nicor is purchasing gas for customers. It is fairly clear from these numbers that Nicor did little, if anything, to actually improve its purchasing strategies to benefit customers. Nicor employee, X X X X X X X, echoes my belief:

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Q. Nicor witness Bartlett states that during the PBR, Nicor had the lowest gas costs among the six largest Illinois natural gas utilities. (Nicor Ex. 1.0, p. 4). How was Nicor able to divert tens of millions of dollars from ratepayers, as Staff suggests, and yet keep gas costs low for ratepayers?

A. Most of Nicor's gains occurred from liquidating the low-cost LIFO layers from storage. This did not cost ratepayers anything in the short term, but rather reduced potential gains for ratepayers in the long term. Think of the LIFO gas in storage as an attic full of antiques passed down for generations. These antiques have great worth on the open market and you could profit greatly from selling them. If a fire were to destroy all of those antiques, the immediate monetary loss would be negligible since they cost you next to nothing to acquire and store them. However, your opportunity losses would be great, as you could have sold them down the road for a large profit. Thus the fire did not cost the owner any money directly out of pocket but it did cause the owner lost value in the future. Nicor's actions operated the exact same way. The Company took an asset that had great future value to ratepayers, and sold it, perhaps for less than it would have been worth later, all the while taking 50% of the profits. This is how gas costs remained steady while Nicor profited on the backs of ratepayers.

<u>Nicor's Improper Practices, Transactions, and Conduct</u>

Q. Has Nicor engaged in improper practices, transactions and conduct during the PBR program?

A. Yes. Some of these were described in the Lassar report (Stipulated Exhibit 6), which was later adopted by the Company.

Q. Would Staff have uncovered any of Nicor's misconduct were it not for the whistleblower memo to CUB?

A. No, it is extremely doubtful that Staff would have uncovered many, if any, of Nicor's improper transactions. In fact, Staff and the other parties had basically concluded the PBR review case of 02-0067 when the whistleblower memo was distributed. Up to that point, Staff had not identified any of the issues that are a part of our case today. However, Staff did not rely upon the whistleblower memo as a basis for any of its analysis or conclusions. Rather, the whistleblower memo was a catalyst for further in-depth discovery from Staff and other parties. It is the information from data request responses, testimony, and depositions that Staff is relying upon as a basis for its positions.

Q. Regarding the reasons why Staff didn't uncover Nicor's schemes during the 99-0127 and 02-0067 docketed cases, did Staff fail to ask the right questions during those cases?

A. No. Staff did its best to investigate all angles during those two cases, given the complexity and uniqueness of the issues at hand. In fact, as I will show, Staff and the intervening parties did indeed ask questions during the cases that would have revealed some of Nicor's improprieties, had Nicor answered completely and truthfully.

<u>Buckets Reports</u>

Q. How are the buckets reports related to improper conduct on the part of Nicor?

A. The buckets reports are first mentioned earlier in my testimony, in the context of establishing the Company's own calculations of the sources of their "savings" under the PBR. This section of my testimony addresses the fact that the Company generated those documents, had them in their possession, and did not furnish them to Staff and CUB after Nicor had received certain data requests from Staff and CUB.

Q. Were the buckets reports accurate?

A. They were the most accurate reports that the Company had which analyzed and quantified the savings and losses under the PBR. While a few of the numbers were the best estimates of the Company, many of the numbers were known to be accurate. It is important to remember that was the report that managers relied upon to monitor and analyze the profitability of the PBR. This report was not just some "back of the napkin" calculation; this report was the Company's best attempt to track tens of millions of dollars of savings and losses. It is clear that Nicor's own employees believed in the accuracy of the buckets reports:

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Q. Did Staff ever see the buckets reports prior to reopening of 02-0067 due to the whistleblower fax?

A. No. However, it is my belief that Staff should have been given access to these reports in response to several data requests. In early 2002, Staff sent request number POL 1.2 (Stipulated Exhibit 8), which asked Nicor to describe all actions taken by Nicor to save money under the PBR, and to identify the savings for each action. Nicor responded with a very vague and incomplete description of its actions and said, “The Company does not track gas costs or savings in the manner requested.”

Staff followed that response with another request, numbered POL 2.1 (Stipulated Exhibit 9). This request asked for, among other things, “the Company’s best estimate of the total cost of the actions taken by the Company to reduce gas costs since the inception of the GCPP.” The Company again responded that it was “impossible” to identify either the actions taken or the costs associated with such actions.

Finally, CUB also sent a request to Nicor, numbered 1.17 (Stipulated Exhibit 10), which asked the Company to categorize the savings realized under the PBR. Many of the categories listed by CUB were categories that Nicor itself had identified in response to POL 1.2. There was also a catchall category called “other.” Once again, Nicor responded by saying that categorized savings were not available.

Nicor's repeated assertions that it was not able to quantify or categorize savings into individual components were untrue. Nicor had been collecting this exact information since early 2000. Not once did Nicor provide Staff or CUB with the buckets reports, or even so much as admit to their existence. It is my belief that Nicor didn't want Staff to see these reports because they would have alerted Staff to actions such as the LIFO decrement.

Q. Do any of Nicor's employees think that the buckets reports should have been provided in response to these data requests?

A. Yes. Here are a few examples of the thoughts of Nicor's officers:

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<u>Directive to Hide LIFO from Staff</u>

Q. Did Staff realize Nicor's potential to profit from the low cost LIFO storage gas through the PBR?

A. As I stated earlier, Staff was not aware of this possibility. Furthermore, Nicor did its best to ensure that this possibility never crossed the minds of Staff. Nicor repeatedly told Staff in data request response and witness testimony that it could not manipulate storage injections and withdrawals. Moreover, Nicor employees believed there was a corporate directive that no employee was to inform Staff of the LIFO benefit unless asked a direct question. Even when Staff did ask direct questions, such as POL 1.2 and 2.1, Nicor was not forthcoming with regards to its LIFO decrement. Indeed, Nicor has given many vague, misleading, and even false responses to Staff's data requests during 99-0127 and 02-0067.

Q. What do you mean when you say that Nicor had a corporate directive to hide the LIFO benefit from Staff?

A. Several Nicor employees have stated that they understood that they were not supposed to highlight the LIFO benefits to Staff. It is unclear who gave this directive, but it seems to be a widely shared belief that there was indeed such a directive. Consider the sworn depositions of several Nicor employees:

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It is evident from these statements that the directive to hide the LIFO benefit from Staff originated at the beginning of the 99-0127 case. X X X X X X X X X X X X

X So from day one, Nicor made a conscious effort to refrain from discussing LIFO layers in any filing, testimony, or data request response.

Q. Do you have any written documentation of this directive to hide the LIFO strategy from Staff?

A. Yes. NIC 011420-22 (Stipulated Exhibit 19) is a memo from Company employee X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X X XX X

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Up to that point, there had been no LIFO decrement under the PBR program.

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Q. Did Nicor in fact change the format of these reports to Staff, thus obscuring the LIFO benefit?

A. Yes. On the first two quarterly reports, there was a category named “Gas Commodity.” If there had been any LIFO decrement in the first two quarters, it would not have been included in Gas Commodity, but would likely have been classified under its own category, much as it is in the monthly buckets reports. However, when there finally was a LIFO decrement in the third quarter, Nicor changed the name of the “Gas Commodity” category to be “Gas Commodity and Storage.” By accounting for the LIFO decrement in this hybrid category, Nicor effectively hid the decrement from Staff, as it was impossible to determine from where the savings actually came. So not only did Nicor fail to tell Staff during the 99-0127 case that it would be monetizing the LIFO layers, Nicor also went so far as to alter reports so that the LIFO decrement would be concealed.

Q. Does this conclude your direct testimony?

A. Yes.